Saturday 31st August, 2013

Plenary Session 4

9.00am – 10.30am

Paper by

Hon William Gummow AC, Sydney

THE EQUITABLE DUTIES OF COMPANY DIRECTORS

BANKING AND FINANCIAL SERVICES LAW ASSOCIATION

36TH ANNUAL CONFERENCE

Paper by the Hon William Gummow AC

delivered 31 August 2013

THE EQUITABLE DUTIES OF COMPANY DIRECTORS

I recently have written of the difficulties in Anglo-Australian case law concerning the scope of *Barnes v Addy*[1] and will not repeat my conclusions on that subject[2].

The focus of this paper is sharper. The first concern is with the proposition that the directors of a company stand in a fiduciary relation to the company. That status brings with it the proscriptive duties concerned with conflicts of interests and improper derivation of profits.[3] But, as Millett LJ explained in *Bristol and West Building Society v Mathew,*[4] not every breach of duty by a fiduciary is a breach of fiduciary

---

1 (1874) 9 Ch App 244.

2 Gummow, "Knowing Assistance" (2013) 87 *Australian Law Journal* 311.

3 *Breen v Williams* (1996) 186 CLR 71 at 137; *Pilmer v Duke* (2001) 207 CLR 165 at 197-199, [[73]-[79]; [2001] HCA 31.

4 [1998] Ch 1 at 16-17. See also *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FLR 296 at 345-346 [178]-[181].

duty. And, further, it is inappropriate to apply the term breach of fiduciary duty to the failure of a trustee or other fiduciary such as a director, to use proper skill and care in the discharge of his duties. The fact that the source of this and other obligations of directors is to be found in equity rather than the common law does not make it a fiduciary duty[5].

Rather, the fiduciary duties of directors serve to encourage performance of their equitable but non-fiduciary duties. So much was indicated by Gibbs J in *Consul Development Pty Ltd v DPC Estates Pty Ltd*[6].

Some difficulty, if not confusion, has been a legacy of the notion that directors have control of the assets of their company in the same way as the trustee holds the assets of the trust (and the legal title). Thus, in the leading case of *Selangor United Rubber Estates Ltd v Craddock (No 3)*[7], Ungoed-Thomas J approached its application of *Barnes v Addy* to the instant dispute with the bank on the footing that:

---

[5] [1998] Ch 1 at 16. Cf Heydon, "Are the Duties of Company Directors to Exercise Care and Skill Fiduciary?", in Degeling and Edelman (eds) *Equity in Commercial Law* (2005) at 191-198; *Harris v Digital Pulse Pty Ltd* (2003) 56 NSWLR 298 at 406-407.

[6] (1975) 132 CLR 373 at 396-397. See, further, Conaglen, "Fiduciary Loyalty: Protecting the Due Performance of Non-Fiduciary Duties" (2010).

[7] [1968] 1 WLR 1555 at 1577. Similar views had been expressed by Turner LJ in *Bryson v Warwick and Birmingham Canal Co* (1853) 4 De G.M.& G 711 at 730-731 [43 ER 686 at 694].

> "A credit in a company's bank account which the directors are authorised to operate are moneys of the company under the control of those directors and are held by them on trust for the company in accordance with its purposes."

The distinction between fiduciary and other equitable duties is not always appreciated. In *Westpac Banking Corporation v The Bell Group Ltd (In Liq)*[8] ("*Bell*") it was no part of the case against the banks that the directors had breached their duty of care and diligence[9]. Nevertheless, Lee AJA expressed the view that this was a fiduciary duty[10]. However, a study of his Honour's reasons suggests that he may have been using the expression "fiduciary duty" in the looser sense of an equitable obligation attended by equitable remedies. This may also be true of the classification as fiduciary by all members of the Court of Appeal of the two duties of directors (to act in good faith in the best interests of the company, and to act for proper purposes) which were in issue. However, Carr AJA did emphasise (i) that there was no suggestion that the directors had made any gains for themselves or otherwise had conflicting interests, and (ii) he tended to the view that the primary judge may have gone too far in elevating the equitable duties they had breached into fiduciary duties[11].

---

[8] (2012) 89 ACSR 1.

[9] (2012) 89 ACSR 1 at 134 [839].

[10] (2012) 89 ACSR 1 at 134-135 [839]-[845].

[11] (2012) 89 ACSR 1 at 490, 492.

On the other hand, the reasoning in *Grimaldi v Chameleon Mining NL (No 2)*[12] ("*Grimaldi*") is consistent with the better view that, while on the facts of the particular case, a breach of one or more of these duties also may amount to a fiduciary breach, that will not necessarily be so. This view accords with that of Millett LJ in the *Bristol* case, to which reference has been made above. It may be noted that in *Grimaldi* the Full Court concluded that the "commission" given to Mr Grimaldi represented a clear breach by him of fiduciary duty owed by him as director of Chameleon[13].

Why does the distinction between fiduciary duty and other equitable duties matter? One consideration is the position of third parties. Where they are accessories to a breach of fiduciary duties, understood in the proscriptive sense, the body of case law respecting the two "limbs" of *Barnes v Addy*, whatever its difficulties, is readily attracted. Where the third parties are accessories to other species of unconscientious conduct by the fiduciary, specifically failure to discharge the fiduciary's other equitable obligations, there is scope for a more flexible approach both to liabilities and to remedies. But it is not accurate to say that unless the obligations to exercise reasonable care

---

12 (2012) 200 FCR 296.

13 (2012) 200 FCR 296 at 350-351 [210]-[212].

and skill is fiduciary a third party who assists, even dishonestly, in breach of that duty escapes liability in equity[14].

Reasonable diligence

Something further needs to be said here respecting the doctrinal foundation of the duty of directors to use what might be identified as reasonable diligence, in the sense of proper skill and care, in the discharge of the office of director.

In *Peninsular and Oriental Steam Navigation Company v Johnson*[15] Latham CJ observed that while, "merely" in the capacity as director a director is not a trustee for shareholders, "in the exercise of his powers he is trustee for the company". Earlier, in *Austin v Austin*[16], Griffith CJ, Barton and O'Connor JJ endorsed the proposition that one duty of a trustee, in managing trust affairs, is to take those precautions which an ordinary man of business would take in managing similar affairs of his own.

Writing in the second edition of his work "The Principles of Company Law", published in 1957[17], Professor Gower regarded the

---

[14] Cf Goldfinch "Trustee's Duty to Exercise Reasonable Care: Fiduciary Duty?" (2004) 78 *Australian Law Journal* 678 at 686.

[15] (1938) 60 CLR 189 at 218.

[16] (1906) 3 CLR 516 at 525-529.

[17] At 472.

analogy between the obligation of directors and that of trustees with respect to duties of care and skill as breaking down; this was because the primary obligation of directors is to seek profits from speculative activities while that of trustees of a will or settlement is to avoid risks to the trust fund. But, in more recent times, the trust is used extensively in business structures of an entrepreneurial nature.

To conclude that the duty of directors to exercise care and skill is drawn by equity entirely from the trustee analogy would be to underplay the capacity of equity to "follow the law" by drawing strength from common law (and statutory) principles. An example of that capacity, with respect to the rejection of proofs of equitable debts which are barred by analogy to the Statutes of Limitations, is given by Kitto J in *Motor Terms Pty Ltd v Liberty Insurance Ltd*[18].

The powers of directors, to which, for example, the equitable duty respecting care and skill attaches, are sourced in the relevant statute and in the constituent documents of the company.

It should be emphasised that the powers exercised by directors are thus legal in character; but equity then operates upon the manner of the exercise of those legal powers.

---

[18] (1967) 116 CLR 177 at 181-182. See, further, Radan and Stewart "Principles of Australian Equity and Trusts" 2nd ed. (2013) at ¶31.25-31.31, ¶2.21-2.26.

In *The Commonwealth v Colonial Combing Spinning and Weaving Co Ltd*[19], Higgins J, with particular reference to what had been said by Lord Parker of Waddington in *Vatcher v Paull*[20], and in "Farwell on Powers"[21], considered the expression "fraud on the power". The position of the donee of a legal power is referable to the express or implied terms of the instrument creating the power, rather than to a state of conscience imputed to the donee by courts of equity; nevertheless there is a strong analogy between the obligations of a donee and those of a trustee.

In *Fouche v The Superannuation Fund Board*[22] orders were made in equity, directed to the board members, in respect of their duty to carry out with reasonable care their functions of management of the corporate trustee, a trustee for statutory purposes under the *Superannuation Act* 1938 (Tas); the failure of the directors to do so had caused a breach of trust by the corporation and detriment to the trust property. Dixon, McTiernan and Fullagar JJ held that the duty of the directors, enforceable in equity, did not differ materially from that of trustees with respect to investments, and required the directors to provide equitable

---

19 (1922) 31 CLR 421 at 470-471.

20 [1915] AC 372 at 378.

21 3rd ed at 458.

22 (1952) 88 CLR 609.

compensation to the corporate trustee to the extent necessary to redress its breach of trust and the detriment to the trust property[23].

Statutory duties

It was in this state of authority in the High Court that s 124 appeared in the *Uniform Companies Acts* of 1961.

This read:

> "**124**. (1) A director shall at all times act honestly and use reasonable diligence in the discharge of the duties of his office.
>
> (2) An officer of a company shall not make use of any information acquired by virtue of his position as an officer to gain directly or indirectly an improper advantage for himself or to cause detriment to the company.
>
> (3) An officer who commits a breach of any of the provisions of this section shall be–
>
> (a) liable to the company for any profit made by him or for any damage suffered by the company as a result of the breach of any of those provisions; and
>
> (b) guilty of an offence against this Act.
>
> Penalty: Five hundred pounds.
>
> (4) This section is in addition to and not in derogation of any other enactment or rule of law relating to the duty or liability of directors or officers of a company."

---

[23] (1952) 88 CLR 600 at 640-641.

The provenance of this section lay in s 107 of the Victorian 1958 Act. This had introduced a provision not to be found in any other companies legislation in the English speaking world. Whilst considered largely to be declaratory of the existing law, the restatement of principles in s 124 was designed both to be an effective deterrent to misconduct and to free the courts from the technicalities of the existing law[24].

More elaborate provision currently is made by s 180(1) and s 181(1)(b) of the *Corporation Act* 2001 (Cth). Like s 124, but at greater length, s 185 of the 2001 statute states that these earlier provisions (which are "civil penalty provisions") have effect in addition to and not in derogation of any rule of law and they do not prevent the commencement of proceedings for breach of duty or of a liability under such a rule of law[25].

The term "civil penalty provision" engages the complex remedial structure laid out in Pt 9.4B (ss 1317DA–1317S). This includes the provision in s 1317H for "compensation orders" to be made in respect of damage a corporation has suffered by reason of contravention, inter alia, of s 180(1) and s 181.

---

[24] Wallace and Young "Australian Company Law and Practice" (1965) at 393. Section 124 was adopted as s 132 of the Singapore *Companies Act* 1967.

[25] See, generally, *Grimaldi v Chameleon Mining (NO 2)* (2012) 200 FCR 296 at 431-433 [621]-[626]; *Australian Securities and Investments v Vines* (2003) 48 ACSR 322 at 325-327.

Section 181 requires the exercise by directors (and other officers) of their powers and duties "in good faith in the best interests of the corporation" and "for a proper purpose". As noted above, in a given case, of which *R v Byrnes* was one[26], the same facts may give rise to breach of these duties and of proscriptive fiduciary duties; but not all breaches of these duties will also be abuse of fiduciary duties.

A particular focus of this paper is upon s 180(1). This states:

> "**180(1) Care and diligence – directors and other officers**. A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:
>
> (a) were a director officer of a corporation in the corporation's circumstances; and
>
> (b) occupied the office held by, and had the same responsibilities within the corporation as, the director of officer."

The authorities applying s 180(1) were reviewed by Gzell J in *Australian Securities and Investments Commission v Macdonald*[27]; his Honour's decision was reversed by the Court of Appeal but restored on further appeal to the High Court.[28]

---

[26] (1995) 183 CLR 501.

[27] (2009) 256 ALR 199 at 245-250 [233]-[257].

[28] *Australian Securities and Investments Commissioner v Hellicar* (2012) 286 ALR 501; [2012] HCA 17.

Third parties

What of third parties? Here the legislation (s 181(4)) distinguishes between contravention of the care and diligence requirement in s 180(1) and the "good faith" and "proper purpose" requirements in s 181(1). Those who are "involved in" a contravention of the latter provision, but not the former, are themselves taken to have contravened the provision. What suffices for this involvement in a contravention is spelled out in s 79 as follows:

> "**79** A person is involved in a contravention if, and only if, the person:
>
> (a) has aided, abetted, counselled or procured the contravention; or
>
> (b) had induced, whether by threats or promises or otherwise, the contravention; or
>
> (c) has been in any way, by act or omission, directly or indirectly, knowingly concerned in, or party to, the contravention; or
>
> (d) has conspired with others to effect the contravention."

The question then arises whether, in a situation (as in s 180(1)) where the statute does not provide for accessorial liability attaching to a failure by a director to exercise due care and diligence, equity should do so. In *Grimaldi*[29] the Full Court referred to the variety of circumstances in which and the bases on which equity intervenes to attach participatory

---

[29] (2012) 200 FCR 296 at 357-358 [247].

responsibilities to third parties (including cases of breach of confidence[30] and abuse of relationships of influence[31]); their Honours noted the absence of "inflexible formulae" in these cases.

To repeat, in the situation where the statutory regime dealing with care and diligence does not provide for accessorial liability, should equity do so? If so, should this be on a different basis to that spelled out in s 79?

Reference has been made above to the capacity of equity to "follow the law". The reference by Deane J in *Moorgate Tobacco Ltd v Philip Morris Ltd [No 2]*[32] to the significance of federal trade practices legislation in fixing the area of legal or equitable restraint in matters of unfair competition should be borne in mind when considering the scope of equitable intervention with respect to the consequences of failure by directors to exercise adequate care and diligence. It also should be recalled that in *Barnes v Addy* itself, Lord Selborne LC had cautioned that there can be "no better mode of undermining the source of doctrines

---

30 See *Vestergaard Frandsen A/S v Bestnet Europe Ltd* [2013] UKSC 31; Toulson and Phipps "Confidentiality" 3rd ed (2012) at ¶3-052-¶3-077; Radan and Stewart "Principles of Australian Equity and Trusts" 2nd ed. (2013) at ¶8.86-8.88.

31 *Garcia v National Australia Bank* (1998) 194 CLR 395 at 408-411 [33]-[40]; *O'Sullivan v Management Agency Ltd* [1985] QB 428.

32 (1984) 156 CLR 414 at 445; [1984] HCA 36. See also *CSR Ltd v Eddy* (2005) 226 CLR 1 at 27 [54]; [2005] HCA 64 and cf. *Aid/Watch Inc v Federal Commissioner of Taxation* (2010) 241 CLR 529 at 548-550 [20]-[24]; [2010] HCA 42.

of equity than to make unreasonable and inequitable applications of them"[33].

If equity is to intervene in fixing accessorial liability in respect of failures in adequate care and diligence the better view is that it would be a misstep for equity to fix criteria more severe for the third party than those which the statute provides in respect of involvement in breaches of the duties of "good faith" and "proper purpose". This requires attention to the provision made by s 79. The text has been set out above.

Paragraphs (a)-(d) of s 79(1) reproduce the terms of s 75B(1) of the *Trade Practices Act* 1974 (Cth). In 1985, in *Yorke v Lucas*[34], Mason ACJ, Wilson, Dawson JJ decided that notwithstanding that (like ss 180(1), and 181(1)), s 75B dealt with civil rather than criminal liability, the construction of s 75B was heavily influenced by the criminal law. Their Honour's conclusions then appear from the following passages in their reasons[35]:

> "The words used, "aided, abetted, counselled or procured", are taken from the criminal law where they are used to designate participation in a crime as a principal in the second degree or as an accessory before the fact. Both in the case of felonies where the principal offender and the secondary participant commit separate offences, and in the case of misdemeanours where no distinction is drawn

---

[33] (1874) LR 9 Ch App 244 at 251.

[34] (1985) 158 CLR 661.

[35] (1985) 158 CLR 661 at 667, 669-670.

between the two, a person will be guilty of the offences of aiding and abetting or counselling and procuring the commission of an offence only if he intentionally participates in it. To form the requisite intent he must have knowledge of the essential matters which go to make up the offence whether or not he knows that those matters amount to a crime. So much was affirmed recently in *Giorgianni v. The Queen*[36] where the relevant authorities were examined.

…

So far we have dealt only with par.(a) of s.75B which refers to involvement of persons who are accessories. The appellants also rely upon par.(c) of the same section which extends the definition of a person involved to a person who has been in any way, directly or indirectly, knowingly concerned in, or party to, the contravention. There can be no question that a person cannot be knowingly concerned in a contravention unless he has knowledge of the essential facts constituting the contravention.

…

We have already indicated why par.(a) requires knowledge. Paragraph (b), which speaks of inducing a contravention by threats, promises or otherwise, and par.(d), which speaks of conspiring with others to effect a contravention, both clearly require intent based upon knowledge and there is force, we think, in the observation made in the judgment of the Full Court below that there is–

> '... no reason why Parliament would have intended that a section which renders natural persons liable for a contravention by a corporation should require some mental element or absence of innocence in every case to which it refers except one which itself requires in its first limb that the person was 'knowingly' concerned in the contravention.'

In our view, the proper construction of par.(c) requires a party to a contravention to be an intentional participant, the necessary intent being based upon knowledge of the essential elements of the contravention."

---

[36] (1985) 156 CLR 473; [1985] HCA 29.

The references by their Honours in *Yorke v Lucas* to "knowledge" are to be understood with two elaborations[37]. First, a person may have acted dishonestly without appreciating that the act in question was dishonest, "judged by the standards of ordinary, decent people"; secondly, those who "shut their eyes" against the receipt of unwelcome information may nevertheless be fixed with it.

Compound interest

What is the position respecting compound interest? May an award of compound interest be made where the breach of equitable duty by a director did not involve breach of a proscriptive fiduciary duty?

In *Hungerfords v Walker*[38], Mason CJ and Wilson J observed that the disdain of the common law for interest, particularly compound interest, is a relic of earlier times when interest was regarded as necessarily usurious, and noted that simple interest "almost always undercompensates the true loss of the injured party".

In "Scott and Ascher on Trusts"[39] it is said that while "at one time the standard thinking seems to have been that the trustee was ordinarily

---

[37] *Farah Constructions Pty Ltd v Say-Dee Pty Ltd* (2007) 230 CLR 89 at 162 [173]; [2007] HCA 22.

[38] (1989) 171 CLR 125 at [41]; [1989] HCA 8. See to similar effect "Dobbs Law of Remedies" 2nd ed (1993), Vol 1 ¶3.6(4).

[39] 5th ed (2007) ¶24.9.3.

liable for simple interest only" it now "seems clear that compound interest is fairer in a variety of contexts." The cases cited include *Wallersteiner v Moir [No 2]*[40], which concerned the liability of a company director.

In many instances equitable relief may involve the payment of simple interest[41]. But in some cases, including those of money withheld or misapplied in breach of fiduciary duty, the decree might require the payment of compound interest, on rests specified in the decree. This seeks to approximate the profit likely to have been made from the misused money[42]. The approximation must be just that if, as indicated in *Bell*[43], no allowance will be made, in the absence of specific evidence of the revenue position and any tax planning structures of the defendant, for the tax the profit would have attracted.

Particularly where equity proceeds in aid of purely equitable rights it is important to distinguish between the existence of power to award a remedy and the discretion which attends the fashioning of the remedy in

---

40 [1975] 2 QB 373 at 388, 397-399, 406. See also *Thanakharn Kasikorn Thai Chaimkat v Akai Holdings Ltd (No 2)* (2010) 13 HKCFAR 479 at 534-535 [156]-[157].

41 Examples are given in *The Commonwealth v SCI Operations Pty Ltd* (1998) 192 CLR 285 at 316-317 [75]; [1998] HCA 20.

42 *Hungerfords v Walker* (1989) 171 CLR 125 at 148; *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296 at 414 [548]-[552].

43 (2012) 89 ACSR 1 at 192 [1250]-[1260], 481 [2678]. Cf *O'Sullivan v Management Agency* [1985] QB 428 at 460-462, 469, 473.

a particular case. The better view with regard to compound interest is that the power exists, the manner of its exercise being in the discretion of the court[44].

Accordingly, where the participation by a third party in breach of equitable duty by a director has yielded a monetary benefit utilised by the third party in its business equity has the power to award compound interest.[45] This particularly will be so where, as suggested above, the liability of the third party in equity is posited upon knowledge in the sense described in *Yorke v Lucas*[46], and the duty of the director was that to exercise director's powers in good faith in the best interests of the corporation, or the duty to exercise powers for proper purposes (cf. s 181).

Where the equitable duty in question is that of care and diligence (cf. s 180(1)), the requirement that "*Yorke v Lucas* knowledge" be necessary to fix liability in equity upon a third party may be expected to limit the instances where, on the facts, a case is made out against the third party. This will be so at least where the third party has not duped

---

44 "Jacobs Law of Trusts in Australia" 7th ed ¶2209; *Brock v Cole* (1983) 142 DLR (3d) 461 at 466; *Air Canada v Ontario Liquor Control Board* [1997] 2 SCR 581 at [85]; *Bank of America v Mutual Trust Co* [2002] 2 SCR 601 at 618 [41]. Cf *Clarkson v Metal Supplies Ltd* [2008] 3 NZLR 31 at 35-36 [22].

45 See *Ledger v Petanga Nominees Pty Ltd* (1989) 1 WAR 300.

46 (1985) 158 CLR 661 at 667, 669-670.

the director into failure to exercise reasonable diligence on its part, and has not acted as an instigator.

There is a question whether in its auxiliary jurisdiction equity may (not must) award compound interest upon a monetary remedy awarded under a statutory regime such as s 1317H. The judgment of Lord Walker of Gestingthorpe in *Sempra Metals Ltd v Inland Revenue Commissioners*[47] suggests an affirmative answer to that question. Much may turn upon the consistency of such a remedy with the particular statutory regime to which its equitable remedy would be auxiliary[48].

Conclusion

In the exercise of their legal powers, directors owe various equitable, but non-fiduciary, duties. Third parties may become accountable for breaches of those duties if they have had "knowledge" in the sense discussed in this paper. It is unlikely that, on particular facts, breach of the equitable duty of reasonable diligence by a director (rather than breach of the duties of "good faith" and "proper purpose") will attract third party liability. Where liability does attach, there is power for a court of equity to award compound interest.

---

47 [2008] 1 AC 561 at 629-630.

48 See *The Commonwealth v SCI Operations Pty Ltd* (1998) 192 CLR 285 at 317 [76].